

EXHIBIT 5.

SECURITY AND DATA TECHNOLOGIES, INC.

V.

**SCHOOL DISTRICT OF PHILADELPHIA
PHILADELPHIA SCHOOL REFORM**

and

ARLENE C. ACKERMAN

**U.S. DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

**CIVIL ACTION
NO. 12-cv-02393**

**EXPERT REPORT
INCLUDING REBUTTAL REPORT**

OCTOBER 30, 2014





415 Sargon Way • Suite J
Horsham, PA 19044-1289
Phone: (215) 675-8364
Fax: (215) 675-3879
www.wm-cpa.com

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October 30, 2014

Michael D. Homans, Esquire
Flaster, Greenberg P.C.
1600 John F. Kennedy Blvd, 2nd Floor
Philadelphia, PA 19103

**RE: Security and Data Technologies, Inc. v. School District of Philadelphia, Philadelphia
School Reform and Arlene Ackerman
U.S. District Court for the Eastern District of Pennsylvania
Civil Action NO. 12-cv-002393
Expert Report**

Dear Mr. Homans:

I have been engaged to analyze the claim for damages of Security Data Technologies, Inc. ("SDT") against the School District of Philadelphia ("School District"), Philadelphia School Reform ("PSR") and Arlene Ackerman ("Ackerman") related to the deprivation of being awarded the Persistently Dangerous Schools Security Project ("Project").

I acknowledge this report will be used in litigation and that there are no other intended uses of this report. All opinions and conclusions in this report are stated within a reasonable degree of accounting certainty and I reserve the right to change, amend or supplement the opinions and conclusions upon receipt and review of additional information. This report has been prepared in accordance with the Statement on Standards for Consulting Services issued by the American Institute of Certified Public Accountants ("AICPA"). I was not retained to perform an audit, review or compilation as those terms are defined by the AICPA.

Based on my review and analysis, I have determined to a reasonable degree of accounting certainty that Security and Data Technologies, Inc. sustained damages of at least **Two Million, One Hundred Thousand Dollars (\$2,100,000)**.

Respectfully submitted,

A handwritten signature in black ink, appearing to be 'John F. Maloney', written over a circular stamp or seal.

John F. Maloney, CPA, CFF, CVA, ABAR

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THE CLAIM

In June 2012, Security and Data Technologies, Inc. (“SDT” or “Company”) filed an Amended Complaint (“Complaint”) against the School District of Philadelphia (“SD”), Philadelphia School Reform (“PSR”) and Arlene C. Ackerman (“Ackerman”) (collectively “Defendants”) seeking the following listed relief:

- 1) “Declaring the acts and practices complained of herein to be a violation of federal law;
- 2) Enjoining and restraining defendants from violating Section 1981 and Section 1983;
- 3) Enjoining and restraining defendants from retaliating against SDT for opposing their discriminatory and unlawful practices;
- 4) Directing defendants to take such affirmative steps as necessary to ensure that the effects of the unlawful practices complained of herein are eliminated and not repeated;
- 5) Awarding plaintiff such relief as to make it whole for all lost revenues, past and future, which it has suffered and will continue to suffer as a result of the defendants’ improper and discriminatory treatment, including, without limitation, past and future lost revenues, earnings and expenses;
- 6) Awarding compensatory damages for the harm to SDT’s business and reputation from defendants’ actions;
- 7) Awarding punitive damages against Ackerman for her willful and outrageous violation of the law, in her individual capacity;
- 8) Awarding plaintiff the costs of this action, together with reasonable attorneys’ fees;
- 9) Awarding plaintiff its losses from any negative tax consequences that result from a payment of damages; and
- 10) Granting such other and further relief as the Court deems appropriate.”¹

BACKGROUND

From Amended Complaint:

“SDT is a Delaware corporation and has its primary place of business in Newtown, PA. SDT was founded in 1988 and provides integrated security, life safety systems and equipment to public and private customers throughout the mid-Atlantic region.”

“In or around September 2, 2010, in response to concerns raised and the anticipated release of the state report on the School District’s “persistently dangerous” schools, Superintendent Ackerman called a School Safety Plan meeting. At that meeting, she directed School District managers to implement a plan to replace older cameras and security systems at the 19 “persistently dangerous” schools within 30-60 days, on an emergency basis, with the goal of improving safety and preventing further violent acts.”

¹ Amended Complaint.

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“The School District managers decided to contact SDT, the plaintiff in this action, because SDT had demonstrated its ability to successfully perform such work through its past contracts with the School District. SDT had designed, installed and serviced large and complex electronic, security and camera systems at the School District on many prior occasions, including installation of systems and provision of services at the School District headquarters and in at least eight schools, including the cutting-edge High School of the Future in West Philadelphia.”

“SDT was and is an approved vendor with the School District, through the Commonwealth cooperative purchasing contract, obtained through competitive bidding.”

“In response to the request, SDT immediately began putting together the proposal, working with School District officials to understand the needs and demands for the Persistently Dangerous Schools Security Project, touring the schools at issue, working up floor plans for the installation, and meeting with School District personnel.”

“The School District has estimated that the Persistently Dangerous Schools Security Project would cost up to \$7.5 million. SDT's proposal included a provision that it would subcontract at least 67 percent of the construction work to minority- and women-owned firms (33 percent to minority-owned firms and 34 percent to women-owned firms). This proposal exceeded, by far, the minority- and women-owned business goals of the School District, as confirmed by School District managers.”

“On or about September 17, 2010, based on the emergency needs of the School District, School District managers submitted to Ackerman and her assistant, Deputy Superintendent Lee Nunery, a package for SDT to perform the Persistently Dangerous Schools Security Project.”

SDT asserts Ackerman initiated and participated in the decision to discriminate against SDT because of race, and worked with others inside and outside of the School District and the SRC to achieve the desired race discrimination².

The School District of Philadelphia entered into a \$7,500,000 contract with IBS Communications, Inc. (“IBS”) for the Persistently Dangerous Schools Security Project (Exhibit A).

IBS subcontracted 56% of the work on the Project to subcontractors (Exhibit B³).

SDT asserts that as a result of the defendants' conduct, SDT suffered the loss of a \$7.5 million contract.

² Amended Complaint

³ \$4,200,000 divided by \$7,500,000

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The Persistently Dangerous Schools Security Project ("Project") did not require a performance bond from SDT.

SDT typically does not require a bond from its subcontractors.

In deposition testimony, SDT's Vice President of Sales, Kenneth Spressart, indicated the Company suffered damages of \$2,250,000 for lost gross profit. This was calculated by applying a 30% gross profit margin to the contract price of \$7,500,000.

In their preliminary damage calculation, SDT was "looking for 30 percent, which is within our average margin for our schoolwork"⁴.

For SDT, "every job starts at a 35 percent gross margin"⁵.

As to the margin SDT seeks on subcontractor work, Kenneth Spressart, Vice President of Sales at SDT indicated that margin "could be anywhere from, you know, 15 to 20 points up to the same exact margin on the value of the subcontract, and the complexity of the job and the time compression on the job. There is many, many factors that go into, you know, how much exposure we have, how we are getting paid, you know. There is a lot of things that go into what we use to determine what that margin is going to be for subcontractors"⁶.

The Project "was an emergency rush project. There was no formal bid documents produced by the School District of Philadelphia"⁷.

"SDT sells, installs, and services fire and security protection systems and is a wholesale distributor of wire, primarily in Pennsylvania, New Jersey and Delaware. The work performed for fire and security systems is on a fixed price or time and materials contract basis"⁸.

"Revenue from fixed price installation construction contracts is recognized on a percentage-of-completion method, measured by percentage-of-costs incurred to date to estimated total costs for each contract"⁹.

"Contract costs include all direct materials, freight, labor, subcontracting, vehicle and equipment costs, as well as those indirect costs related to contract performance"¹⁰.

⁴ Deposition of Kenneth Spressart, August 6, 2014, p. 9

⁵ Deposition of Kenneth Spressart, August 6, 2014, p. 20

⁶ Deposition of Kenneth Spressart, August 6, 2014, p. 22

⁷ Deposition of Kenneth Spressart, August 6, 2014, p. 62

⁸ Nature of Operations footnote to financial statements from reviewed financial statements prepared by Mayer, Hoffman, McCann, P.C., report dated March 31, 2011.

⁹ Contract Revenue footnote to financial statements from reviewed financial statements prepared by Mayer, Hoffman, McCann, P.C., report dated March 31, 2011.

¹⁰ Contract Revenue footnote to financial statements from reviewed financial statements prepared by Mayer, Hoffman, McCann, P.C., report dated March 31, 2011.

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DAMAGES

SDT is seeking direct damages as a result of the Defendants' actions related to the Persistently Dangerous Schools Security Project. SDT asserts the Defendants' intentionally withheld awarding them a \$7,500,000 contract that was instead awarded to another contractor.

SDT is seeking lost profits on the \$7,500,000 contract. The direct damages claimed were foreseeable and the Defendants' actions were the cause for the lost profits.

Wherever applicable, damages have been calculated based on SDT records.

Exhibit K presents the documents reviewed for this report.

1. FINANCIAL ANALYSIS

Reviewed financial statements of SDT were prepared by Mayer Hoffman McCann, P.C., a certified public accounting firm for the period December 2009-2012. The years 2010 and 2012 included supplemental information for costs of revenue, general and administrative expenses, and contracts in progress schedules. There was no supplemental information for the years 2009 or 2011. For that reason, some information below may exclude 2009 and 2011 if comparative data is not available.

A condensed consolidated statement of operations is presented in Exhibit C.

a. Gross Profit Margin

In the calculation of damages, historic gross profit and gross profit percentages on construction contracts were reviewed. Overall gross profit reported on SDT's financial statements, gross profit on construction projects from financial statements, and contracts that SDT had with the School District were reviewed.

Historic Overall Gross Profit Percentage per Historic Financial Statements

Historic revenues and overall gross percentage, which includes the blend of service, distribution and construction contracts, reported on the Company financial statements for the years 2009-2012, were as follows:

	Revenue	GP%
2009	\$ 14,738,113	25.34%
2010	14,597,143	25.04%
2011	12,588,275	22.67%
2012	14,114,482	23.02%

The overall gross profit percentages presented above represent the blended percentages for construction projects, fire and security protection services and monitoring and the wholesale distribution sales of wire.

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Historic Gross Profit on Construction Contracts Reported On Company Financial Statements

Exhibits D and E set forth the Contracts in Progress schedule per the Company financial statements as of December 31, 2010 and December 31, 2012. Exhibits F and G set forth the replicated Contracts in Progress schedule included in the Company reviewed financial statement for December 31, 2010 and December 31, 2012. A summary of revenue, cost of revenue, gross profit and gross profit percentage on construction contracts in excess of \$75,000 contract price, as identified in the financial statements, is as follows:

	12/31/2010		12/31/2012	
	Contract	From Inception to	Contract	From Inception to
	Totals	12/31/2010	Totals	12/31/2012
Revenue	\$ 5,154,183	\$ 3,446,815	\$ 3,447,762	\$ 2,102,894
Cost of Revenues	3,603,454	2,444,717	2,328,187	1,321,859
Gross Profit	1,550,729	1,002,098	1,119,575	781,035
GP%	30.1%	29.1%	32.5%	37.1%
Mean GP%	33.7%	33.7%	32.8%	32.8%
Median GP%	33.5%	33.5%	29.0%	29.0%

The mean of a set of numbers is their average. The median is the “middle” value in a set of numbers.

Projects with the School District of Philadelphia

Exhibit H sets forth the Job Contract Analysis Report for SDT projects direct with the School District of Philadelphia for the period January 1, 2007 to December 31, 2012. Exhibit I sets forth the Job Contract Analysis Report for SDT projects direct with electrical contractors for the period January 1, 2007 to December 31, 2012. Exhibit J sets forth the summary Contract Analysis of contracts performed for the School District for the period January 1, 2007 to December 31, 2012 derived from Exhibits H and I. Projects are sorted by gross profit percentage from low to high. The summary of revenue, cost of revenue, gross profit, and other contract information was provided by SDT. Certain items (indicated in bold) were adjusted to assure mathematical accuracy of the schedule. The adjustments were made to more accurately reflect the gross profit for projects. The adjustments were primarily due to many contracts on the Job Contract Analysis Report that indicate the job was greater than 100% complete which is not possible. Revised contract costs were primarily adjusted to costs to date so the project was not greater than 100% complete. The aggregate effect of these adjustments was to reduce reported gross profit by approximately \$54,000.

There are 35 total contracts identified on the Exhibit J. Contracts were sorted by gross profit percentage and were separated into 3 groups. Group 1 represents the 10 projects with the lowest gross profit percentage. Group 2 represents the 15 projects with the gross profit in the middle of the low and high. Group 3 represents the 10 projects with the highest gross profit percentage.

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The range of gross profit percentages for each group is as follows:

Group	Projects	low range	high range
1	low 10	-81.26%	27.04%
2	mid 15	27.34%	52.01%
3	high 10	53.24%	87.53%

Total revenue, cost of revenue, gross profit and gross profit percentage for each group is as follows:

Group	Projects	Group as %				overall GP%	mean GP%	median GP%
		of Revenue	Total Revenue	Total Cost	GP			
1	low 10	19.74%	\$ 468,583.69	\$ 427,683.41	\$ 40,900.28	8.73%	-10.56%	0.75%
2	mid 15	70.36%	1,670,353.85	1,075,696.74	594,657.11	35.60%	38.79%	40.00%
3	high 10	9.90%	235,042.56	60,631.96	174,410.60	74.20%	72.29%	73.57%
	Total	100.00%	\$ 2,373,980.10	\$ 1,564,012.11	\$ 809,967.99	34.12%	34.26%	40.00%

The above chart indicates the following:

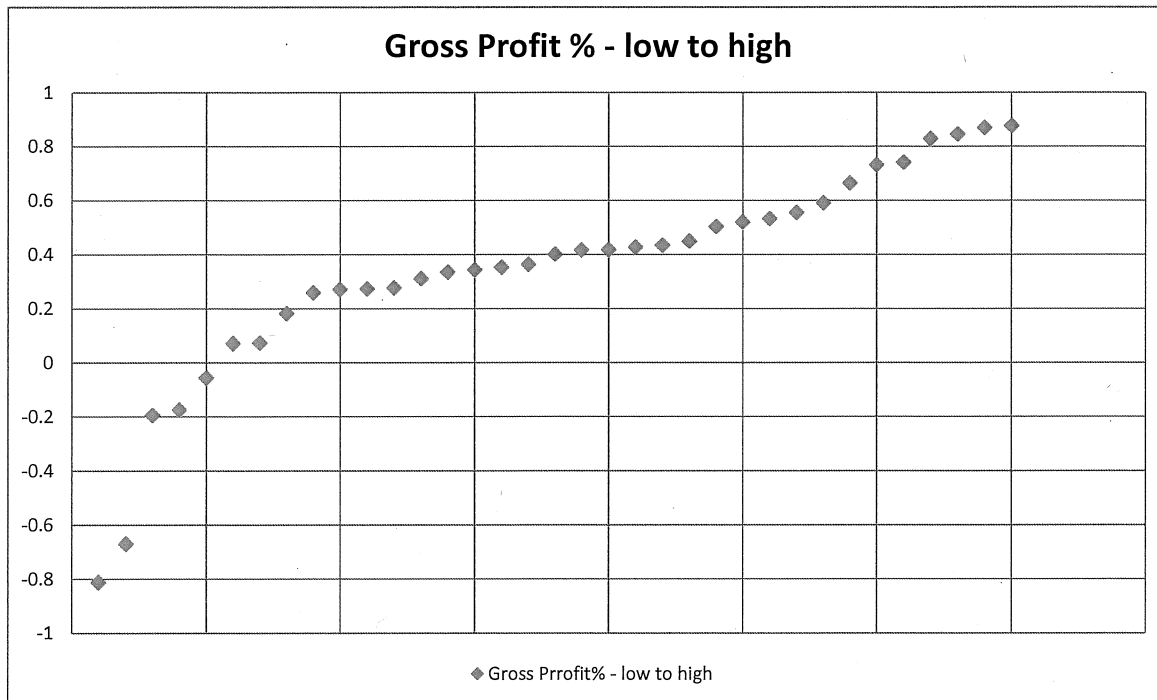
- The overall gross profit¹¹ for Group 1 (the lowest margin projects) was 8.73% (\$40,900.28 divided by \$468,583.69).
- The overall gross profit for Group 2 (the middle range projects) was 35.6%.
- The overall gross profit for Group 3 (the most profitable projects) was 74.2%.
- The median gross profit percentage for Group 2 was 40%.
- The median gross profit percentage for all groups (35 projects) was 40%.
- The 15 projects in Group 2 accounted for 70.36% of the total revenues (\$1,670,353.85 divided by \$2,373,980.10).
- At least 25 out of 35 projects (Group 2 and 3) reported overall gross profit %, mean gross profit percentage, and median gross profit percentage in excess of 35%.

The gross profit percentage on all 35 School District projects, when sorted from lowest gross profit percentage to highest gross profit percentage is presented in the following graph:

¹¹ Overall gross profit is determined by dividing total gross profit on all projects by total revenue.

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As a further analysis, projects were sorted into two groups. Those projects with gross profit percentages less than 30% and projects with gross profit percentages greater than 30% are presented as follows:

	# of projects	Avg GP%
< 30%	12	-4.22%
> 30%	23	54.34%

The above indicates that 23 of 35 projects (65%) reported gross profit percentages greater than 30% and the average gross profit percentage of the same group was 54.34%.

Additionally, there were 8 individual projects with the School District with contract prices in excess of \$100,000:

Job	Name	Contract Amount	Current Estimated Costs	Revised Project Costs	Gross Profit	Gross Profit %
Projects over \$100,000						
1 4643PSD	PHILA SCHL DIST CORE STRNG #4	120,988.76	81,001.00	69,337.78	51,650.98	42.69%
2 4343PSD	PSD CORE SITES RING #2	135,337.05	105,380.00	87,617.10	47,719.95	35.26%
3 4944PSD	PSD-JUANITA PARK ACADEMY CCTV	143,000.00	131,298.00	132,859.04	10,140.96	7.09%
4 4097PSD	PHIL SCH DIST CORE SITE #3	152,497.05	112,836.00	86,228.88	66,268.17	43.46%
5 4260PSD	PSD-FCWINX-SOFTWARE UPDATE	160,000.00	109,091.00	118,612.95	41,387.05	25.87%
6 4180PSD	PHILADELPHIA SCHOOLS RING #1	164,874.03	129,286.00	108,476.97	56,397.06	34.21%
7 4337PSD	PSD-440 BLD TURNSTILES PHS 1-2	389,291.00	255,459.00	248,032.40	141,258.60	36.29%
8 4357PSD	PSD FIRE TOWER-ACC CONTROL DRS	569,718.00	409,190.00	392,859.10	176,858.90	31.04%
		1,835,705.89	1,333,541.00	1,244,024.22	591,681.67	32.23%

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The 8 projects with the School District with contract amounts greater than \$100,000 reported the following:

overall GP%	32.23%
mean GP%	31.99%
median GP%	34.73%

The above indicates no significant variation in gross profit percentage for small versus larger contracts with the School District.

A summary of gross profit percentage computed in this section is as follows:

<u>Summary of Gross Profit Percentage Findings</u>	
<u>Financial Statements</u>	
Historical Overall Gross Profit-2009	25.34%
Historical Overall Gross Profit-2010	25.04%
Historical Overall Gross Profit-2011	22.67%
Historical Overall Gross Profit-2012	23.02%
<u>Gross Profit on Construction Contracts</u>	
Average Gross Profit - 2010	33.70%
Average Gross Profit - 2012	32.80%
Median Gross Profit - 2010	33.50%
Median Gross Profit - 2012	29.00%
<u>Gross Profit on all School District Projects</u>	
Low-10 Overall GP%	8.73%
Low-10 Mean GP%	-10.56%
Low-10 Median GP%	0.75%
Mid-15 Overall GP%	35.60%
Mid-15 Mean GP%	38.79%
Mid-15 Median GP%	40.00%
High-10 Overall GP%	74.20%
High-10 Mean GP%	72.29%
High-10 Median GP%	73.57%
<u>Gross Profit on SD Projects greater than \$100,000</u>	
Overall GP%	32.23%
Mean GP%	31.99%
Median GP%	34.73%

The median gross profit percentage reported on the contracts in progress schedule of SDT's financial statements for 2012 of 29% was selected to determine the damages on the Project. This amount represented the median for construction projects that were bid closest to the time the Project would have been awarded.

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b. General and Administrative Expenses

Costs of revenue include engineers, service, project management and technicians labor. Other direct costs such as material costs, subcontracting costs and other project related costs are included in arriving at gross profit.

General and administrative expenses for SDT include advertising, promotion, bad debt expense, depreciation, equipment leasing, insurance, office expense, professional fees, sales salaries, communications, travel and utilities.

A summary of general and administrative expenses of SDT for the period 2010 and 2012 (per reviewed financial statements) is as follows:

General and Administrative Expenses	12/31/2010		12/31/2012	
Sales Salaries, Payroll Taxes, Medical and Life Insurance, and Pension Plan	\$ 2,492,915	17.08%	\$ 2,017,943	14.30%
Insurance - General	231,683	1.59%	265,616	1.88%
Office Expense	122,585	0.84%	122,217	0.87%
Professional Fees	83,563	0.57%	69,293	0.49%
Telecommunications	90,800	0.62%	102,548	0.73%
Advertising & Promotion	85,894	0.59%	76,159	0.54%
Bad Debts	69,314	0.47%	37,540	0.27%
Equipment Leasing	38,060	0.26%	39,110	0.28%
Depreciation	24,692	0.17%	20,446	0.14%
Dues & Subscriptions	4,937	0.03%	5,544	0.04%
Meals and Entertainment	24,929	0.17%	34,849	0.25%
Postage and Shipping	5,743	0.04%	5,600	0.04%
Taxes	14,531	0.10%	40,474	0.29%
Travel	7,208	0.05%	43,103	0.31%
Utilities	33,645	0.23%	27,104	0.19%
Total G&A Expenses	\$ 3,330,499	22.82%	\$ 2,907,546	20.60%

Total labor including sales salaries, payroll taxes, pension plan expense and medical and life insurance represent approximately 70-75% of total general and administrative expenses. These amounts represent 14%-17% of revenues. Other than general insurance and office expense, it is unlikely general and administrative expenses would increase if SDT obtained an additional \$7.5M project. However, it is unlikely that general insurance and office expense would increase proportionate to an increase in revenue. General insurance and office expense for the 2 years above were 2.43% and 2.75% of revenue. It is reasonable that general insurance and office expense could increase by 1% of additional revenue.

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2. DAMAGE CALCULATION

Based on the financial analysis damages for the lost profits related to the loss of the Project are calculated as follows:

Lost Contract Price	\$ 7,500,000
Gross Profit Percentage Selected	29.0%
Gross Profit on Contract	\$ 2,175,000
General & Administrative Expenses at 1% of contract price	(75,000)
Contract Damages	\$ 2,100,000

The gross profit percentage utilized was the median gross profit on Construction Contracts for 2012 identified above. It was determined that the additional work would increase general and administrative expenses by 1% of revenue.

By adding the contract amount, cost of revenue and related to gross profit to the Company's 2010 and 2011 originally issued financial statements, overall gross profit percentages would increase 1.34% (26.38% - 25.04%) in 2010 and 2.36% in 2011. The re-casted gross profit percentage of 26.38% and 25.03% is not significantly different than the overall gross profit percentages range of 22.67%-25.34% for the period 2009-2012.

	12/31/2010			12/31/2011		
	Originally Reported	Add: Project	Re-Casted Amounts	Originally Reported	Add: Project	Re-Casted Amounts
Revenue	\$ 14,597,143	\$ 7,500,000	\$ 22,097,143	\$ 12,588,275	\$ 7,500,000	\$ 20,088,275
Cost of Revenue	10,942,606	5,325,000	16,267,606	9,734,374	5,325,000	15,059,374
Gross Profit	3,654,537	2,175,000	5,829,537	2,853,901	2,175,000	5,028,901
GP%	25.04%	29.00%	26.38%	22.67%	29.00%	25.03%

3. VAN NOY REPORT

Defendants engaged an expert, Tim Van Noy ("Van Noy") of Eisner Amper, to "review the claims of Security & Data Technologies, Inc."¹² and issue an expert report ("Van Noy Report").

The Van Noy Report provided the following "opinion that SDT's purported damages are unreliable and speculative for the following reasons:

1. SDT's use of gross profit margin as a measure of damages excludes any incremental Project costs which would have been recorded in general and administrative expenses;
2. SDT's application of gross profit percentage to the entire Project amount results in unreasonable markups on subcontractor costs;

¹² Van Noy Expert Report

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3. The variability in SDT's historical gross profit percentages realized on School District work makes SDT's average gross profit percentage an unreliable predictor of the profit to be earned on the Project.
4. SDT failed to address the basic foundational elements for reasonably estimating its damages, if any, for not obtaining the Project, including:
 - a. Preparing a proper estimate of the Project costs;
 - b. Obtaining pricing from subcontractors;
 - c. Evaluating the demands of operational and financial resources required by the Project; and
 - d. Evaluating if its historical gross profit percentage is a reliable measure of gross profit on the Project.”¹³.

a. Exclusion of incremental Project costs recorded in general and administrative expenses

Van Noy states that “any additional cost of the Project that is part of general and administrative expense is ignored by SDT's damages calculation”¹⁴.

General and administrative expenses for SDT include advertising, promotion, bad debt expense, depreciation, equipment leasing, insurance, office expense, professional fees, sales salaries, communications, travel and utilities.

Total labor including sales salaries, payroll taxes, pension plan expense and medical and life insurance represent approximately 70-75% of total general and administrative expenses. General and administrative expenses can be relatively fixed and will not increase significantly as volume increases or decreases. Also, general and administrative expenses don't necessarily increase or decrease proportionately to fluctuations in revenue.

b. Unreasonable markup on subcontractor costs

The construction industry offers a variety of challenges. Each construction business owner must identify, analyze and respond to specific risks related to a project and to their entire business enterprise, and price work in accordance with those anticipated risks. Construction projects are complex. Risk management is critical and probably the most difficult part of a project. It is important to account for risks in the bid process. Management demands certain margins to account for such things as risk of default on a project, default on creditors and a general fear of losing everything. It is not unusual for management to build in higher profit margins to mitigate risk. Risk factors that affect a construction project may include:

¹³ Van Noy Report, p. 9

¹⁴ Van Noy Report, p. 9

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- | | |
|---|--|
| <ul style="list-style-type: none"> • Work conditions • Weather • Site conditions • Scheduling • Subcontractor performance • Material delivery • Project management and oversight • Labor shortage | <ul style="list-style-type: none"> • Owner expectations • Scope management • Integration management • Project design • Interference • Contract terms • Price escalation • Subcontractor financial difficulties |
|---|--|

It is important for contractors to mitigate risk and be compensated for the inherent risks associated with each project. Not all companies handle risk the same. The greater the risk the greater the desired margin.

A company's strategy is typically to avoid risk, mitigate risk, accept risk and transfer risk. Risk is avoided by not accepting projects. One way to mitigate or transfer risk would be obtaining performance bonds from a subcontractor. Risk is accepted when management believes they are being compensated for the risk.

Van Noy indicates in his report that in the construction industry "a more typical markup on subcontractor work would be in the 5 percent to 10 percent range"¹⁵. This is a general comment that does not consider the risk factors associated with each individual subcontractor and their financial and performance capabilities. This comment ignores the specific facts and circumstances SDT faced in regards to subcontractor performance.

Approximately 56% of the Project cost was attributed to subcontracting expense. SDT did not require a performance bond from subcontractors thereby increasing their risk on the project. For SDT, the subcontractors were not bonded. There was an expectation that the subcontractors would perform the work. However, it was SDT's responsibility to complete work in the event of a subcontractor default. SDT would bear the risk of quickly hiring a replacement contractor and completing the project on time. It is possible this would add delay to the project. To mitigate these types of risk, it is common for contractors to markup subcontractor costs.

Kenneth Spressart, Vice President of Sales at SDT indicated that margin "could be anywhere from, you know, 15 to 20 points up to the same exact margin on the value of the subcontract, and the complexity of the job and the time compression on the job. There is many, many factors that go into, you know, how much exposure we have, how we are getting paid, you know. There is a lot of things that go into what we use to determine what that margin is going to be for subcontractors"¹⁶.

Assume SDT was awarded the contract for \$7,500,000 and produced a 29% gross margin percentage on the job. If 56% of the Project was subcontracting that would equate to approximate contract value of \$4,200,000 (\$7,500,000 x 56%) and the remainder of SDT work would be \$3,300,000, the same breakdown for IBS.

¹⁵ Van Noy Report, p. 7

¹⁶ Deposition of Kenneth Spressart, August 6, 2014, p. 22

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Assuming a 50% gross profit margin on SDT work and alternatively, a 40% gross profit margin on SDT work, the resulting breakdown would be as follows:

	56%		
	SDT	Subs	Total
Revenue	3,300,000	4,200,000	7,500,000
Cost of Revenue	1,650,000	3,675,000	5,325,000
Gross Profit	1,650,000	525,000	2,175,000
GP%	50.00%	12.50%	29.00%

	56%		
	SDT	Subs	Total
Revenue	3,300,000	4,200,000	7,500,000
Cost of Revenue	1,980,000	3,345,000	5,325,000
Gross Profit	1,320,000	855,000	2,175,000
GP%	40.00%	20.36%	29.00%

Gross profit percentage on subcontract work would be 12.50% to 20.36%. This is within reason of the 15-20% or greater margin they typically anticipate.

c. Variability in historical gross profit percentages on School District work.

Gross Margin Percentage on School District Projects

Upon review of the SDT projects with the School District, Van Noy indicates SDT's logic was flawed in the development of their preliminary damage calculation because SDT "assumed it would have achieved its alleged average gross profit percentage on the full value of the Project"¹⁷ and they "assumed that average gross profit is the proper measure of its damages"¹⁸.

Van Noy indicates that SDT School District work has a "wide range of gross profit percentages, from negative 81.26% to positive 91.88%, with what appears to be significant variability"¹⁹. It is misleading for Van Noy to put emphasis on such a wide range of values. Yes, SDT did have a project with the School District with a negative 81.06% gross profit. However, the total contract amount for that project is \$505. The total contract amount for the project with the highest gross profit margin of 87.53% was \$60,820.

It is important to pay attention to the project gross profit percentage in the middle, review average gross profit percentages as well as median gross profit percentages. The focus becomes less on the noise created by the high and low extremes. Based on the analysis in this report, the median gross profit percentage on School District projects is 40%. The overall gross profit percentage, mean gross profit percentage and median gross profit percentage on projects with the School District in excess of

¹⁷ Van Noy Report, p. 6

¹⁸ Van Noy Report, p. 6

¹⁹ Van Noy Report, p. 6